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No. 85-681

In the Supreme Court of the United States

OCTOBER TERM, 1985

WESTERN RESERVE OIL AND GAS CO., LTD., ET AL., PETITIONERS

v.

H. STEVEN NEW, ET AL.

ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE NINTH CIRCUIT

MEMORANDUM FOR THE RESPONDENTS IN OPPOSITION

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Petitioners brought this action for damages against Internal Revenue Service (IRS) personnel, alleging that their rights of due process under the Fifth Amendment to the United States Constitution had been violated by the IRS's issuance of "pre-filing notification letters" to investors in the petitioners' limited partnerships.

1. At the time pertinent to this action, petitioner Trevor Phillips was the sole general partner of two California limited partnerships, Western Reserve Oil and Gas Company (Western Reserve) and 1983 Western Reserve Oil and Gas Company (1983 Western Reserve), which were in the business of producing and developing oil and gas during calendar year 1983 (Pet. App. A4-A6). Various other individuals had purchased interests in the limited partnerships (*id.* at A5).

The Internal Revenue Service informed Phillips, in a standard "pre-filing notification letter," that it believed that there was "a basis for concluding that the partners of [Western Reserve and 1983 Western Reserve] will not be in compliance with the Federal income tax laws if they claim the tax benefits represented by the general partners and promoters to be available" (Pet. App. A22-A23 n.2). The letter offered Phillips an opportunity, which he accepted, to meet with representatives of the IRS and present facts and legal arguments showing that the claimed tax benefits complied with federal income tax laws (*ibid.*; *id.* at A6). See Rev. Proc. 83-78, 1983-2 C. B. 595. Following the meeting, however, the IRS sent each of Western Reserve's partners a pre-filing notification letter advising them that it believed deductions or credits purportedly accruing to Western Reserve were not allowable, and that it planned to examine returns claiming such deductions or credits and to disallow them (Pet. App. A6; *id.* at A24 n.3).

2. Petitioners then instituted this action for damages in district court (Pet. App. A4). In their complaint, as amended, they alleged that the issuance of the pre-filing notification letters deprived them of liberty and property without due process of law in violation of the Fifth Amendment, in that the mailing of the letters had (1) the " 'irreversible consequence of destroying the means by which Phillips secure[d] his livelihood,' " (2) "a 'chilling effect' because investors would withdraw," and (3) "the letters had the same damaging effect on his lifelihood [*sic*] as a 'jeopardy assessment' " (*id.* at A7, quoting complaint). The complaint stated that the respondents acted " 'under color of authority' " in issuing the pre-filing notification letters, but that the action was motivated by a personal animosity toward a business partner of Phillips whom the IRS personnel hoped to " 'injure, embarrass and destroy' " (*id.* at A7-A8, quoting complaint). The complaint also

alleged that the meeting with the IRS did not satisfy the requirements of due process because Phillips was not given sufficient notice and explanation of the IRS's position (*id.* at A8).

The district court granted respondents' motion to dismiss the action (Pet. App. B14), holding that the complaint failed to state a cognizable claim (*id.* at B4-B9), and that, in any event, respondents were immune from suit (*id.* at B9-B14). Petitioners appealed and the court of appeals affirmed (*id.* at A21; the court of appeals' decision is reported at 765 F.2d 1428).

The court of appeals held that petitioners had failed to allege the deprivation of a property or liberty interest cognizable under the Fifth Amendment (Pet. App. A9-A16). The property claim was rejected (*id.* at A10-A13) since Phillips had no legitimate claim of entitlement to operate a business in violation of the tax laws (*id.* at A12); the court of appeals cited as support *Mid-South Music Corp.* v. *Kolak,* 756 F.2d 23 (6th Cir. 1984), and *Investment Annuity, Inc.* v. *Blumenthal,* 609 F.2d 1 (D.C. Cir. 1979), cert. denied, 446 U.S. 981 (1980). The liberty interest claim was also rejected (Pet. App. A13-A15) and *Sanderson* v. *Village of Greenhills,* 726 F.2d 284 (6th Cir. 1984), distinguished, since "the regulatory basis for the actions of the federal agents is clearly set forth in the complaint" (Pet. App. A15). With regard to the claim that Internal Revenue Service personnel acted with malice, the court found that such conduct here would not constitute the denial of a liberty or property interest either (Pet. App. A15-A16).

The court of appeals also held that no violation of procedural due process had occurred (Pet. App. A16-A18). It reasoned that a hearing is not constitutionally required prior to the assessment or collection of taxes, so long as the

aggrieved party has an opportunity for later judicial determination of liability, citing, inter alia, *Phillips* v. *Commissioner*, 283 U.S. 589, 595 (1931) (Pet. App. A17-A18). In this case, it pointed out, Congress has provided for suits regarding adjustment or readjustment of disputed partnership items (765 F.2d at 1434; the supporting citation by the court of appeals to 26 U.S.C. 6226 and 6228 is omitted at Pet. App. A18, and 28 U.S.C. 1346(a)(1) is miscited as "26 U.S.C. 1346(a)(1)").[1]

3. The decision below in this fact-bound action is correct, and is in accord with decisions of other circuits. No further review is warranted.[2]

The Secretary of the Treasury may, under 26 U.S.C. 6302(b), use such "reasonable devices or methods as may be necessary or helpful in securing a complete and proper collection" of taxes. This Court has stated that the Internal

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[1]The court of appeals also found (Pet. App. A18-A20) the respondents to have acted within their statutory authority. It is relevant to an immunity inquiry, of course, whether an official has violated any "clearly established *statutory* or constitutional rights," *Harlow* v. *Fitzgerald*, 457 U.S. 800, 818 (1982) (emphasis added), but the court had earlier said it would not reach the immunity question (Pet. App. A22 n.1). There was no need to do so, since the court had already concluded that there was no due process violation.

[2]Petitioners have raised a number of issues in their petition for the first time in this case. For example, they urge that various sections of the Internal Revenue Code are unconstitutional (Pet. 1, 11-12, 14-15, 46, 54, 56), that they suffered cruel and unusual punishment at the hands of respondents (Pet. 7), that respondents abridged their First Amendment freedom of association (Pet. 8-9,10), that Rev. Proc. 83-78, *supra*, is void for vagueness (Pet. 13), that excessive bail was set (Pet. 30), and that the notice provisions of 26 U.S.C. 6331(d)(2) and 6703 were somehow violated (Pet. 13-14). These contentions and other allegations of misconduct were neither asserted in petitioners' complaint nor raised in any other manner below. Accordingly, they are not properly before this Court. See, *e.g.*, *Kosak* v. *United States*, No. 82-618 (Mar. 21, 1984), slip op. 2 n.3; *United States* v. *Lovasco*, 431 U.S. 783, 788-789 n.7 (1977).

Revenue Code "imposes on the Secretary * * * a broad duty to enforce the tax laws," *United States* v. *Euge*, 444 U.S. 707, 716 (1980), and that Congress intended "to provide the Secretary with broad latitude to adopt enforcement techniques helpful in the performance of his tax collection and assessment responsibilities" (*id.* at 716 n.9). The pre-filing notification letters here were such a reasonable device. See *Mid-South Music Corp.* v. *United States Dep't of the Treasury*, 579 F. Supp. 481, 483-484 (M.D. Tenn. 1983), aff'd *sub nom. Mid-South Music Corp.* v. *Kolak*, 756 F.2d 23 (6th Cir. 1984).

a. The mere allegation of a constitutional cause of action is not sufficient to survive a motion to dismiss if the constitutional claims are "frivolous," "insubstantial," "patently without merit," or "immaterial and made solely for the purpose of obtaining jurisdiction." See *Butz* v. *Economou*, 438 U.S. 478, 507-508 (1978); *Duke Power Co.* v. *Carolina Environmental Study Group, Inc.*, 438 U.S. 59, 70 (1978); *Bell* v. *Hood*, 327 U.S. 678, 682-683 (1946). Petitioners' Fifth Amendment claim is patently frivolous, and the dismissal of petitioners' action was properly affirmed by the court of appeals.

As the Sixth Circuit concluded in *Mid-South Music Corp.* v. *Kolak*, 756 F.2d 23, 25 (1984), the claimant's interest in doing business free of the IRS's conveying information it believes to be accurate to taxpayers, and the relationship between the pre-filing notification letters and the alleged injury (a loss of patronage from the recipients of such letters), are too attenuated to implicate the Due Process Clause. See also *Bob Jones University* v. *Simon*, 416 U.S. 725, 746-748 (1974); *Investment Annuity, Inc.* v. *Blumenthal*, 609 F.2d at 7. One must have a "legitimate claim of entitlement" to a benefit in order to claim a property interest in it. *Board of Regents* v. *Roth*, 408 U.S. 564,

577 (1972). Petitioners here have only a unilateral expectation of continued patronage from investors and their associates, and that is not a constitutionally protected property interest. *Ibid; Investment Annuity, Inc.* v. *Blumenthal*, 609 F.2d at 7-8. Nor have the petitioners been deprived of a "liberty interest." Their claim that the designation of Western Reserve as an abusive tax shelter in the pre-filing notification letters has impaired their business opportunities amounts to nothing more than a purported defamation. The imposition of a defamatory stigma upon a citizen by an official acting under color of law does not constitute a deprivation of liberty within the meaning of the Fifth Amendment; it is, at most, a common-law tort. See *Paul* v. *Davis*, 424 U.S. 693 (1976); *Rutledge* v. *Arizona Board of Regents*, 660 F.2d 1345, 1353 (9th Cir. 1981), aff'd *sub nom. Kush* v. *Rutledge*, 460 U.S. 719 (1983). There is also no plausible suggestion that the IRS has "foreclosed [petitioners'] freedom to take advantage of other [business] opportunities." *Board of Regents* v. *Roth*, 408 U.S. at 573.

In any event, petitioners' due process claim is meritless since, as the court of appeals explained (Pet. App. A17-A18), they have adequate post-enforcement opportunities for judicial review. Congress has provided for later judicial determinations of liability in this area, which is all that due process requires. *Bob Jones University* v. *Simon*, 416 U.S. at 746-748; *Phillips* v. *Commissioner*, 283 U.S. 589, 595-601 (1931); *Rosenberg* v. *Commissioner*, 450 F.2d 529, 531-533 (10th Cir. 1971). Phillips, on behalf of all the partners, may litigate the propriety of any disputed tax benefits deriving from Western Reserve in the Tax Court, the district courts, or the Claims Court. See 26 U.S.C. 6226 and 6228.[3]

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[3]Even where a hearing is provided for under Internal Revenue Service procedural rules, the failure to provide it does not violate a taxpayer's due process rights, because such rules are merely "directory rather than

b. Finally, it is apparent that respondents are entitled to the defense of official immunity. They did not violate any clearly established statutory or constitutional rights; indeed, the issuance of pre-filing notification letters had been approved by the only court to have addressed the question. See *Mid-South Music Corp.* v. *United States Dep't of the Treasury, supra.* Regardless of petitioners' allegations of malicious intent, then, respondents would enjoy qualified immunity from suit, if not absolute immunity. *Harlow* v. *Fitzgerald,* 457 U.S. 800, 817-818 (1982); see also *Davis* v. *Scherer,* No. 83-490 (June 28, 1984).

It is therefore respectfully submitted that the petition for a writ of certiorari should be denied.

Respectfully submitted.

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mandatory." *Rosenberg* v. *Commissioner,* 450 F.2d at 533; *Cleveland Trust Co.* v. *United States,* 421 F.2d 475, 481-482 (6th Cir.), cert. denied, 400 U.S. 819 (1970); *Luhring* v. *Glotzbach,* 304 F.2d 560, 565 (4th Cir. 1962).